

SUMMARY ANALYSIS OF AMENDED BILL

Author: Klehs Analyst: Gail Hall Bill Number: AB 675
 Related Bills: See Prior Analysis Telephone: 845-6111 Amended Date: June 20, 2006
 Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Require Certain Corporations To Report Tax and Book Differences/Penalty For Failure/FTB Report To Legislature Regarding Book Income and Tax Shelter Activities

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended _____.

AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended _____.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO _____.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED

☒ MAY 1, 2006, STILL APPLIES.

☒ OTHER – See comments below.

SUMMARY

This bill would require certain corporations to provide detailed information on the differences between book income and taxable income.

SUMMARY OF AMENDMENTS

The June 20, 2006, amendments made the following changes to the bill:

- Revised the information return (CA Schedule M-3) filing requirement.
- Revised the failure to furnish penalty for the CA Schedule M-3.
- Added a false or incomplete information return penalty.
- Added a reporting requirement for the Franchise Tax Board (FTB).

Except for the discussion in this analysis, the remainder of the department's analysis of the bill as amended May 1, 2006, still applies.

Board Position:

_____ S _____ NA _____ NP
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 _____ N _____ OUA _____ X PENDING

Legislative Director

Date

Brian Putler

7/21/06

POSITION

Pending.

ANALYSIS

THIS BILL

This bill would require a corporation whose stock is commonly traded on a public stock exchange to file with its tax return a CA Schedule M-3. The CA Schedule M-3 would consist of a reconciliation of financial statement net income or loss to the net income or loss reported on the tax return. The reconciliation would include the distributive share of items from a unitary partnership.

In addition, this bill would impose two penalties relating to the CA Schedule M-3, one relating to failing to furnish the CA Schedule M-3 and one relating to filing a false or incomplete CA Schedule M-3. The failure to furnish penalty would equal \$15,000 unless the failure was due to reasonable cause and not willful neglect. The false or incomplete CA Schedule M-3 penalty would equal \$50,000. There would be two exceptions to imposing the penalty:

1. FTB notifies the corporation that the CA Schedule M-3 is false or incomplete, and the corporation corrects the schedule within 60 days from the date of the notice.
2. The Chief Counsel of FTB rescinds all or any portion of the false or incomplete penalty if both of the following apply:
 - a. Imposing the penalty would be against equity and good conscience.
 - b. Rescinding the penalty would promote tax compliance and effective tax administration.

The failure to furnish and false or incomplete return penalties added by this bill shall be in addition to any other penalty provided by law.

This bill would require FTB to report to the Legislature, on or before December 1, 2011, the level of compliance and a discussion of the relative value of the information with respect to increasing accuracy in book income reported and identifying participation of tax shelter activities. The report shall include significant differences between book income and taxable income.

IMPLEMENTATION CONSIDERATIONS

1. The author should consider defining "corporation whose stock is commonly traded on a public stock exchange" because the term is broad and may be subject to many interpretations.
2. If less than 100 percent of a group of corporations filing a California combined tax return are publicly traded, the bill would require only publicly traded corporations to file a CA Schedule M-3. The CA Schedule M-3 is a detailed reconciliation of book income to taxable income. If less than 100 percent of corporations in a California tax return are

required to file a CA Schedule M-3, the detailed reconciliation of book income to taxable income would be incomplete and less effective because the detail would be absent for nonpublic corporations. If this is the author's intent, no amendments are necessary.

TECHNICAL CONSIDERATIONS

To clearly distinguish between the two penalties imposed under this bill, it is recommended the failure to furnish penalty is revised to a failure to file penalty with the due date of the CA Schedule M-3 set the same as the due date of the return. (See Amendment 1)

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

The revenue discussion in the analysis of the bill as amended May 1, 2006, still applies, except for the addition of a penalty for filing a false or incomplete CA Schedule M-3.

The book-to-tax-income reconciliation would be a significant audit tool. This tool could assist auditors in identifying tax shelter activity and could dissuade some taxpayers from entering into tax avoidance schemes. The revenue gain is dependent on the number and size of tax shelters identified, the amount of additional income self-reported by taxpayers, and the number of taxpayers that fail to provide the CA Schedule M-3 or file a false or incomplete CA Schedule M-3. Because future corporate tax shelter activities are unknown, it is not possible to calculate the revenue gain from future audit assessments and penalties.

ARGUMENTS/POLICY CONSIDERATIONS

1. The Internal Revenue Service (IRS) has recognized that tax shelters and tax avoidance schemes could be entered into by many forms of entities (i.e., partnerships and S corporations), and therefore, in addition to corporations, will require federal Schedule M-3's to be filed for partnerships and S corporations. This bill would exclude business entities other than corporations (i.e., partnerships, limited liability companies) from the CA Schedule M-3 filing requirement and most S corporations because it is rare that any of these business entities are publicly traded.
2. Requiring publicly traded corporations to provide detailed information relating to differences between book and taxable income would provide investors protection against corporations manipulating accounting transactions to overstate book income.
3. This bill would create differences between federal and California tax reporting, thereby increasing the complexity of California tax return preparation.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 675
As Amended June 20, 2006

AMENDMENT 1

On page 3, delete lines 23 through 28, and insert:

(c)(1) The information required by subdivision (a) shall be filed by the due date of the return as prescribed by Section 18601.

(2) If any taxpayer fails to make and file an information return required by subdivision (a) on or before the due date of the return as prescribed in paragraph (1), a \$15,000 penalty shall be imposed for each failure, unless the failure is due to reasonable cause and not due to willful neglect.